Supreme Court, U.S.
FILED
JUN 30 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1160

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1987

DUQUESNE LIGHT COMPANY
and
PENNSYLVANIA POWER COMPANY,
Appellants

v.

DAVID M. BARASCH, ET AL.,
Appellees

On Appeal from the Supreme Court of Pennsylvania

BRIEF FOR CONSUMER FEDERATION OF AMERICA, ENVIRONMENTAL ACTION, AND CITIZEN/LABOR ENERGY COALITION

Scott Hempling
Counsel of Record

Environmental Action Foundation
1525 New Hampshire Ave.
Washington, DC 20036
(202) 745-4871

Roger Colton

72 Maple St.
Belmont, MA 02178

June 30, 1988

TABLE OF CONTENTS

INTEREST OF AMICI CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. APPELLANTS' INSISTENCE ON AUTOMATIC RECOVERY OF PRUDENT INVESTMENT IN CANCELLED PLANT CONFLICTS WITH THIS COURT'S TAKINGS PRECEDENT 4

A. The Legal Test for Takings in the Regulatory Context . . . 4

B. The Pennsylvania Statute Embodies a Proper Public Purpose 10

1. The Legal Standard . . . 10

2. Application 12

C. The Pennsylvania Statute Does Not Extinguish a Fundamental Attribute Of Ownership . . . 15

1. The Legal Standard . . . 15

2. Application 16

D. The Pennsylvania Statute Has No Economic Impact Which Conflicts With Distinct, Reasonable, Investment-Backed Expectations 19

1. The Legal Standards . . 19

2. Appellants' Facial Challenge to Section 1315's Economic Impact

Must Fail 31

3. Appellants Have Not Demonstrated That Section 1315, As Applied, Diminishes Shareholder Value 36

4. Section 1315, As Applied, Does Not Interfere With Any Distinct, Reasonable, Investment-Backed Expectation 41

II. THE METHOD FOR ASSIGNING PROSPECTIVELY THE RISK OF UNECONOMIC INVESTMENT IS A MATTER OF POLICY, NOT CONSTITUTIONAL LAW 56

CONCLUSION 64

TABLE OF AUTHORITIES

COURT CASES

Agins v. City of Tiburon,
447 U.S. 255 (1980) 16

Andrus v. Allard,
444 U.S. 51 (1979) 18,
20, 24, 27, 30, 36, 38

Armstrong v. United States,
364 U.S. 40 (1960) 10

Barasch v. Pennsylvania Pub. Util.
Comm'n, 532 A.2d 325 (Pa. 1987) . . . 45

Bell Tele. Co. v. Pennsylvania
Public Utility Commission,
408 A.2d 917 (Pa. Commw. 1979) 43

Bluefield Water Works & Improvement Co. v.
Public Service Commission,
262 U.S. 679 (1923) 51, 52

Board of Regents v. Roth,
408 U.S. 564 (1972) 31

City of Pittsburgh v. Pennsylvania
Public Utility Commission,
171 Pa. Super. 187, 90 A.2d 607
(1952) 41

Day v. Public Service Commission,
312 Pa. 381, 167 A. 565 (1933) 55

Demorest v. City Bank Co.,
321 U.S. 36 (1944) 57

Duquesne Light Co. v. Pennsylvania
Public Utility Commission,
107 A.2d 745 (Pa. 1954) 43

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) . . 51, 580

Goldblatt v. Hempstead, 369 U.S. 590 (1962) 12, 21

Hawaii Housing Authority v. Midkiff, 467 U.S. 229 (1984) 14

Hodel v. Irving, ___ U.S. ___, 107 S.Ct. 2076 (1987) . . 5, 6, 10, 11, 16, 17, 26, 28, 41, 56

Hodel v. Virginia Surface Mining and Reclamation Ass'n, Inc., 452 U.S. 264 (1981) 19, 21, 33

Iowa-Illinois Gas and Electric Co. v. Iowa State Commerce Commission, 412 N.W.2d 600 (Iowa 1987) 55

Jackson v. Metropolitan Edison Co., 419 U.S. 345 (1974) 49

Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (1987) 13, 53

Kaiser Aetna v. United States, 444 U.S. 164 (1979) . 4, 6, 16, 28, 55, 56

Keystone Bituminous Coal Ass'n v. DeBenedictis, ___ U.S. ___, 107 S.Ct. 1232 (1987) 5, 11, 12, 14-17, 19, 20, 23, 24, 26, 30, 32-34, 55

Kimball Laundry Co. v. United States, 338 U.S. 1 (1949) 11

Lake Nacimiento Ranch v. San Luis Obispo County, 830 F.2d 977 (9th Cir. 1987) 21, 26

Loretto v. Teleprompter Manhattan CATV,
458 U.S. 419 (1982) . . 5, 15-18, 28, 32

Los Angeles Gas and Electric Corp.
v. Railroad Commission of California,
289 U.S. 287 (1933) 52

MacLeod v. Santa Clara County,
749 F.2d 541 (9th Cir. 1984) 38

Market St. Railway v. Railroad Commission,
324 U.S. 548 (1945) 40, 46, 52

Miller v. Schoene,
276 U.S. 272 (1928) 11

Montana Power Co. v. Montana Public Service
Commission, 692 P.2d 423
(Mont. 1984) 55

Office of Consumers' Counsel v. Public
Utilities Commission, 67 Ohio St. 153,
423 N.E.2d 820 (1981), appeal dismissed,
455 U.S. 914 (1982) 59

Office of Consumers' Counsel v. Public
Utility Commission, 4 Ohio St. 3d 111,
115, 447 N.E.2d 749, 753-54 (1983) . . 59

Paradise v. Pennsylvania Public Utility
Commission, 184 Pa.Super. 8,
132 A.2d 754, 758 (1957) 55

Penn Central Transportation Co. v.
New York City, 438 U.S. 104 (1978) . . 5,
6, 10, 12, 15, 20, 21, 25, 27, 29, 31,
33, 34, 36, 56

Penn Power Co. v. Pennsylvania
Public Utility Commission,
412 A.2d 903 (Pa. Commw. 1980) 43

Pennsylvania Coal Co. v. Mahon,
260 U.S. 393 (1922) 11, 32

Permian Basin Area Rate Cases,
390 U.S. 747 (1968) 13

Power Reactor Development Co. v.
Electricians, 367 U.S. 396 (1961) . . 52

Schuykill Valley Lines v. Pennsylvania
Public Utility Commission, 165 Pa.
Super. 393, 68 A.2d 448 (Pa. 1949) . . 42

Snyder v. Pennsylvania Public Utility
Commission, 187 Pa.Super. 147,
144 A.2d 468 (1958) 55

State of Missouri ex rel. Southwestern
Telephone Co. v. Public Service
Commission, 262 U.S. 276 (1923) . . . 13

U.S. v. Willow River Co.,
324 U.S. 499 (1945) 9, 28, 29

United States v. Central Eureka
Mining Co., 357 U.S. 155 (1958) . . . 11

Washington Gas & Light Co. v. Baker,
188 F.2d 11 (D.C. Cir. 1950),
cert. denied, 340 U.S. 952 (1951) . 13,
53

Webb's Fabulous Pharmacies, Inc. v.
Beckwith, 449 U.S. 155 (1980) 31

Western & Southern Life Insurance Co. v.
State Bd. of Equalization,
451 U.S. 648 (1981) 15

Williamson Planning Commission v.
Hamilton Bank, 473 U.S. 172 (1985) . . 34

ADMINISTRATIVE DECISIONS

Atlantic City Elec. Co., 51 P.U.R.4th 109 (N.J.Bd. of P.U. 1983) 58

Bangor-Hydro Elec. Co., 46 P.U.R. 503 (Me. PUC 1982) 58

Carolina Power and Light Co., 49 P.U.R. 4th 188 (N.C. Util. Comm'n 1982) 58

Investigation of the Need for Additional Electric Generating and Transmission Facilities, 46 Pa. P.U.C. 23 (1972) . 46

Lower Valley & Light, Inc., No. 9617-sub 11 (Wyo. PSC Dec. 2, 1982) 59

Notice of Proposed Rulemaking, "Regulations Governing Independent Power Producers," RM88-4-000 (Federal Energy Regulatory Commission Mar. 16, 1988) 37

Pacific Power & Light Co., 49 P.U.R.4th 82 (Or. PUC 1982) 59

Pacific Power and Light Co., 53 P.U.R.4th 24 (Mont. PSC 1983) 59

Pennsylvania Public Utilities Commission v. Duquesne Light Co., 5 P.U.R.4th 202 (Penn. PUC 1974) 44

Pennsylvania Public Utility Commission v. Duquesne Light Co., 97 P.U.R.3d 227 (Penn. PUC 1972) 43

Philadelphia Electric Co. v. Pennsylvania Public Utility Commission, 37 P.U.R.4th 381 (Penn. PUC 1980) 63

Portland Gen. Elec. Co.,
49 P.U.R.4th 274 (Or. PUC 1982) . . 59

Potomac Elec. Power Co.,
50 P.U.R.4th 500 (D.C. PSC 1982) . . 58

Rochester Gas and Elec. Corp.,
45 P.U.R.4th 386 (NY PSC 1982) 57

Washington Utils. & Trans. Commission v. Pacific Power and Light Co.,
52 P.U.R.4th 148 (Wash. UTC 1983) . . 60

West Palm Beach Water Co. v. City of West Palm Beach, P.U.R. 1930A 177 (S.D.Fla. 1928) (aff'g Report of Special Master) 48

MISCELLANEOUS

66 Pa.C.S. sec. 1315 . . . . . passim

Case and Schoenbrod, Electricity or the Environment: A Study of Public Regulation without Public Control,
61 CALIF. L. REV. 961, 972 (1973) . . 48

Cleaves, Constitutional Protection for the Utility Investor: The Confiscation Doctrine after Cleveland Electric Illuminating Co. v. Public Utilities Commission of Ohio, 12 B.C.L. ENVTL. L. REV. 527 (1985) 58

J. BONBRIGHT, A. DANIELSEN, D. KAMERSCHEN, PRINCIPLES OF PUBLIC UTILITY RATES (1988) 40, 52

Lippek, Power and the Environment: A Statutory Approach to Electric Facility Siting,
47 WASH. L. REV. 35 (1971) 49

Sommers, Recovery of Electric Utility Losses from Abandoned Construction Projects, 8 WM. MITCHELL L. REV. 363, (1982) 58

Wilson, Ratemaking Treatment of Abandoned Generating Plant Losses, 8 WM. MITCHELL L. REV. 343, 352-358 (1982) 58

INTEREST OF AMICI CURIAE

Consumer Federation of America ("CFA"), a non-profit organization founded in 1968, is the nation's largest consumer advocacy organization. CFA's membership encompasses more than 200 national, state and local consumer, senior citizen, low-income, union, farm, labor, public power and cooperative organizations representing more than 35 million people. **Environmental Action ("EA")** is a non-profit, environmental research and education organization based in Washington, D.C., with members located throughout the United States. **Citizen/Labor Energy Coalition ("C/LEC")**, founded in 1978, is a coalition of labor, citizen, religious and community organizations working on energy issues affecting low and moderate income groups.

Collectively, amici represent consumers of electricity and residents of communities affected by electric utility investment

decisions. They seek to ensure that regulatory treatment of investment by investor-owned utilities is responsive to consumer, community and environmental concerns.

SUMMARY OF ARGUMENT

Section 1315, the Pennsylvania statute[1] denying Appellants retail rate recovery of their approximately $50 million investment in cancelled nuclear plants, is not confiscatory. At the time they made this investment, Appellants had no property interest in exacting charges for a product their customers cannot use. Section 1315, as interpreted by the Pennsylvania Supreme Court in the decision below, merely codified the existing ban on such charges. Therefore, Section 1315 does not work a "taking" under the Fifth Amendment to the U.S. Constitution.

---

[1] 66 Pa.C.S. sec. 1315.

This Court generally has examined takings challenges by engaging in "essentially ad hoc, factual inquiries." In the special context of utility regulation, where clear risk assignment is essential to the efficient implementation of long-term capacity planning, the ad noc approach does not work well. Amici therefore propose a constitutional test which (1) adheres to this Court's takings precedent; (2) leaves regulatory jurisdictions free to choose among various methods of assigning and compensating for risk; but (3) avoids the inherent unpredictability of the ad hoc approach.

Specifically, a regulatory act is a taking only if it (a) does not advance a legitimate state interest; (b) has a character which conflicts with a fundamental attribute of property ownership; or (c) causes a diminution in value which is inconsistent with distinct,

reasonable, investment-backed expectations.

Appellants ask this Court to impose a "prudent investment rule" as the constitutional standard. Such a rule would supersede states' diverse experiments in risk assignment, while violating this Court's admonition that the result, not the method, must control constitutional review of utility regulatory decisions.

ARGUMENT

I. APPELLANTS' INSISTENCE ON AUTOMATIC RECOVERY OF PRUDENT INVESTMENT IN CANCELLED PLANT CONFLICTS WITH THIS COURT'S TAKINGS PRECEDENT

A. The Legal Test for Takings in the Regulatory Context

This Court generally has "examined the 'taking' question by engaging in essentially ad hoc, factual inquiries...." Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979). These "factual inquiries" generally involve two analytical steps. First, the Court identifies the relevant

factors. Four factors have appeared most frequently: (1) legitimacy of the "public purpose," Keystone Bituminous Coal Ass'n v. DeBenedictis, ___ U.S. ___, 107 S.Ct. 1232, 1242 (1987); (2) "character of the government action," Penn Central Transportation Co. v. New York City, 438 U.S. 104, 124 (1978); (3) "economic impact," Hodel v. Irving, ___ U.S. ___, 107 S.Ct. 2076, 2082 (1987); and (4) "interfere[nce] with distinct investment-backed expectations," Penn Central, supra, 438 U.S. at 124.

Second, the Court determines what role each factor should play in the analysis of the challenged governmental action. Perhaps reflecting the "ad hoc" nature of the Court's takings inquiries, the role of each factor has varied. For example, in Loretto v. Teleprompter Manhattan CATV, 458 U.S. 419 (1982), the "character" of the government action -- requiring apartment

building owners to permit cable television companies to attach equipment to building roofs -- made it a taking per se. But in Hodel v. Irving, supra, the Court appeared to "weigh" and "balance" character along with the other three factors. [2] Cf., Kaiser Aetna, supra, 444 U.S. at 178 and n.9 (while "[m]ore than one factor" contributed to Court's finding of a taking, Court did not decide "whether in some

---

[2] The statute challenged in Hodel v. Irving prohibited Sioux Indians with less than two percent interests in certain parcels of land to pass on those interests to their heirs. They could either sell their interests to other tribal members, or have their interests escheat to the tribe upon their death. In invalidating the statute, the Court strongly suggested that the statute's character -- a "total abrogation" of a fundamental property right [the right to pass on property to heirs] -- made it a taking per se. See 107 S.Ct. at 2083-84. Yet the Court also appeared to treat the four factors as items to be weighed independently and balanced. See 107 S.Ct. at 2083 ("[a]lso weighing weakly in favor of the statute ... is something of an 'average reciprocity of advantage'"); and n.2 (describing the analysis as "the Penn Central balancing test").

circumstances one of these factors by itself may be dispositive").

Amici do not seek to modify the Court's general approach to takings cases. But in the specific context of utility ratemaking, where clear risk assignment is central to efficient, long-term capacity planning, the unpredictability inherent in the ad hoc approach does not work well. The need for predictability aside, the various interests affected by regulatory policy -- utility management, shareholders, competitors and customers -- hold conflicting views on such key planning questions as who should bear the economic risks, and capture the economic benefits, of utility decisionmaking.

We therefore propose a framework for analyzing takings claims in the context of utility ratemaking. This framework (1) assures that regulatory treatment of utility investment is predictable and

internally consistent; (2) protects utility property interests; and (3) leaves the various interests free to debate, in advance of construction, the policy issue of who should bear risk and capture benefits. That framework is as follows:

First, where a utility volunteers for the duty and privilege of providing franchise service, the regulatory agency (or legislature) is free to assign in advance, in any manner it wishes, the economic risks associated with providing such service. The agency's policy must be consistent with this Court's "public purpose" and "character" requirements. Second, where such advance risk assignment creates expectations that rise to the level of a property right, the utility is entitled to rates which are consistent with those expectations. As with all takings cases, the burden rests with the utility to demonstrate that rates conflict with

distinct, reasonable, investment-backed expectations.

Appellants' attack on Section 1315 is circular. It boils down to the following syllogism: (1) denial of recovery of "property dedicated to public use" is a taking; (2) cancelled plant is "property dedicated to public use"; (3) therefore, denial of recovery of cancelled plant is a taking. Appellants beg one of the key questions in this case: whether their decision to build the cancelled plants was based on a distinct, reasonable, investment-backed expectation of freedom from economic risk.

"We cannot start the process of decision by calling such a claim as we have here a 'property right'; whether it is a property right is really the question to be answered." U.S. v. Willow River Co., 324 U.S. 499, 502-03 (1945). As discussed below, that question must be answered in

the negative.

B. The Pennsylvania Statute Embodies a Proper Public Purpose

1. The Legal Standard

"Public purpose" review ensures that the "alleged 'taking' is for a valid 'public use' within the meaning of the Fifth Amendment." Hodel v. Irving, supra, 107 S. Ct. at 2089 (Stevens, J., concurring). The general test is whether the statute forces "some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." Armstrong v. United States, 364 U.S. 40, 49 (1960).

That a statute leaves the claimant "more burdened than benefitted" does not invalidate it. Penn Central, supra, 438 U.S. at 133-35. As this Court recently declared: "While each of us is burdened somewhat by such restrictions, we, in turn benefit greatly from the restrictions that

are placed on others....These restrictions are 'properly treated as part of the burden of common citizenship.'" [3] This requirement of "reciprocity of advantage" will be met where the statute benefits "widely varying interests," Keystone, supra, 107 S.Ct. at 1242-43, or where there is "substantial overlap" between the burdened and benefited citizens, Hodel v. Irving, supra, 107 S.Ct at 2083. Exemplifying these characteristics would be a statute designed to protect a state's economy. [4]

---

[3] Keystone, supra, 107 S.Ct. at 1245 (quoting Kimball Laundry Co. v. United States, 338 U.S. 1, 5 (1949)). See also Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) ("reciprocity of advantage" justifies burdening some more than others).

[4] See, e.g., Keystone, 107 S.Ct. at 1243 ("fiscal integrity of the [affected] area" a proper goal); United States v. Central Eureka Mining Co., 357 U.S. 155 (1958) (Government order closing gold mines so that skilled miners would be available for other mining work based on proper purpose); Miller v. Schoene, 276 U.S. 272, 279 (1928) (destruction of red cedar trees

This Court will not second-guess legislative judgments as to whether a regulatory scheme benefits the public at large. [5] And in determining legislative purpose, this Court will defer to statutory interpretations reached by lower courts. [6] Finally, the burden of demonstrating the unreasonableness of government's use of the police power lies with the plaintiff. [7]

2. Application

Section 1315 prohibits Appellants from

---

to save nearby apple trees a proper purpose where apple industry was more important to state's economy).

[5] See, e.g., Penn Central, supra, 438 U.S. at 134 (deferring to City Council's judgment that "the preservation of landmarks benefits all New York citizens and all structures, both economically and by improving the quality of life in the city as a whole...").

[6] Keystone, supra, 107 S.Ct. at 1242 and n.15.

[7] See Goldblatt v. Hempstead, 369 U.S. 590, 596 (1962) ("Our past cases leave no doubt that appellants had the burden on 'reasonableness.'...").

recovering cancelled plant costs in retail rates. It effectively bars Appellants from charging captive ratepayers for a product they cannot use, did not request and do not want. The clear purpose of the statute is to prevent what the Pennsylvania Legislature deemed to be monopoly abuse of captive customers. The courts have found that purpose to be proper, repeatedly. [8]

Appellants intimate (Br. at 19) that Section 1315's purpose is improper because

---

[8] See, e.g., State of Missouri ex rel. Southwestern Telephone Co. v. Public Service Commission, 262 U.S. 276, 290 (1923) (Brandeis, J., dissenting) (public interest includes protection from rates which are "prohibitive, exorbitant, or unduly burdensome to the public"); Permian Basin Area Rate Cases, 390 U.S. 747, 768-69 (1968) (noting public interest in satisfying consumers' concern about reasonable prices); Washington Gas & Light Co. v. Baker, 188 F.2d 11, 15 (D.C. Cir. 1950) (protection of consumers from exorbitant rates is a proper public purpose), cert. denied, 340 U.S. 952 (1951); Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1181 n.34 (1987) (ratepayer must be protected from "exploitation," regardless of the resulting impact on the utility).

it merely favors one set of private interests (ratepayers) over another set (shareholders). But reasonable rates benefit utilities as well as ratepayers. Reduced electricity costs make the utility's business customers more competitive, and leave residential customers with more disposable income. The resulting economic development can increase utility revenues. Section 1315 thus embodies the "reciprocity of advantage" which has vindicated numerous other regulatory actions. [9]

---

[9] The legitimacy of a statute's purpose is, of course, "subject to independent scrutiny by this Court." Keystone, supra, 107 S.Ct. at 1256 (Rehnquist, J., dissenting). But only the state courts can determine what the statutory purpose was. Moreover, only the state can make the policy judgments which determine when the public interest is served by placing limits on certain private interests, and how to design those limits. Cf., Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 242 (1984) ("'whether in fact the provisions will accomplish the objectives is not the question: the [constitutional requirement] is satisfied

C. The Pennsylvania Statute Does Not Extinguish a Fundamental Attribute Of Ownership

1. The Legal Standard

The "character of the government action" is a factor distinct from the "purpose" of the action. [10] In Loretto, supra, the Court held that "a permanent physical occupation authorized by government is a taking without regard to the public interests that it may serve."

---

if ... the ... [State] Legislature rationally could have believed that the [Act] would promote its objective'") (quoting Western & Southern Life Insurance Co. v. State Bd. of Equalization, 451 U.S. 648, 671-72 (1981)) (quoted in Keystone, supra, 107 S.Ct. at 1255-56 n.3 (Rehnquist, J., dissenting)).

[10] See Keystone, supra, 107 S.Ct. at 1244 n.18 ("a 'taking' may more readily be found when the interference with property can be characterized as a physical invasion by government, ... than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good") (citations omitted). See also Penn Central, supra, 438 U.S. at 124; Loretto, supra, 458 U.S. at 426.

458 U.S. at 426. [11]

Circumstances warranting per se invalidation on grounds of character are "very narrow," Loretto, supra, 458 U.S. at 441; or "extraordinary," Hodel v. Irving, supra, 107 S.Ct. at 2083. Thus economic regulation which completely prohibits use of particular property is still economic regulation, not physical appropriation. [12]

2. Application

Appellants argue (Br. at 31-32 n.25)

---

[11] Cf., Kaiser Aetna, supra, 444 U.S. at 176 (right to exclude is "one of the most essential sticks in the bundle of rights that are commonly characterized as property"); Hodel v. Irving, supra, 107 S.Ct. at 2083 (statute "amounts to virtually the abrogation of [a] right ... [which] has been part of the Anglo-American legal system since feudal times").

[12] See, e.g., Keystone, 107 S.Ct. at 1244 n.18 ("the Court has repeatedly upheld regulations that destroy or adversely affect real property interests"); Agins v. City of Tiburon, 447 U.S. 255, 262 (1980) (restrictions on economic development do not, alone, amount to a taking where they do not "extinguish a fundamental attribute of ownership").

that Section 1315's denial of recovery is analogous to "physical invasion by government." The analogy is unacceptably strained. The statute does not work a physical invasion, and it does not appropriate property. Rather, it "restrains uses of property." Keystone, supra, 107 S.Ct. at 1245. Specifically, Section 1315 deprives Appellants of their wish to charge captive customers for a product they do not want. That wish hardly constitutes a right which "has been part of the Anglo-American legal system since feudal times." Hodel v. Irving, supra, 107 S.Ct. at 2083.

Contrary to Appellants' assertion, Loretto, supra, does not apply to the instant case. By specifically authorizing permanent physical occupation, the Loretto statute prevented the property owner from making any use of the occupied area. In contrast, as discussed in Part I.D.2,

infra, Appellants remain free to use the fruits of their $50 million investment, with one exception: they may not impose the costs on retail ratepayers. As the Loretto Court stated:

> To borrow a metaphor, cf. Andrus v. Allard, 444 U.S. 51, 65-66 (1979), the government [in authorizing a physical invasion] does not simply take a single 'strand' from the 'bundle' of property rights: it chops through the bundle, taking a slice of every strand.
>
> Property rights in a physical thing have been described as the rights "to possess, use and dispose of it." [citation omitted] To the extent that the government permanently occupies physical property, it effectively destroys each of these rights.

Loretto, supra, 458 U.S. at 435 (emphasis in original). Because Appellants remain free to utilize their cancelled plant investment in other ways, they have lost only one strand, if any. [13]

---

[13] We argue in Part I.D.4, infra, that Appellants had no reasonable expectation, and therefore no property interest, in charging captive ratepayers for a product

D. The Pennsylvania Statute Has No Economic Impact Which Conflicts With Distinct, Reasonable, Investment-Backed Expectations

1. The Legal Standards

A taking occurs where (a) there is a diminution of value, (b) caused by government action, (c) which is inconsistent with distinct, reasonable, investment-backed expectations. We discuss each of these factors in turn.

a. Did the utility suffer a diminution of value"? The takings analysis proceeds only if the statute necessarily "denies an owner economically viable use of his land." Hodel v. Virginia Surface Mining and Reclamation Ass'n, Inc., 452 U.S. 264, 294-96 (1981). To establish the absence of economic viability -- an "uphill battle," Keystone, supra, 107 S.Ct. at 1247 -- the claimant must clear three hurdles.

---

they do not want. Consequently, Appellants never owned the strand they claim to have lost.

First, the claimant cannot simply carve out the affected property and insist it was taken. "[W]here an owner possesses a full 'bundle' of property rights, the destruction of one 'strand' of the bundle is not a taking because the aggregate must be viewed in its entirety." Andrus v. Allard, supra, 444 U.S. at 65-66. [14]

Second, the claimant must prove there are no alternative uses for the affected property. This requirement flows from the

---

[14] In Andrus, it was "crucial that appellees retain the rights to possess and transport their property,...to donate or devise the protected birds, and to exhibit the artifacts for an admissions charge." 444 U.S. at 66. And in Keystone, supra, appellants argued unsuccessfully that the statute constituted a taking of the 27 million tons required to be left in the ground. That coal was not a separate segment of property for takings law purposes. 107 S.Ct. at 1248-49. See also Penn Central, supra, 438 U.S. at 130-31 (rejecting argument that "air rights" above the terminal constituted a separate segment of property; Court must "focus ... on the nature of the interference with rights in the parcel as a whole).

principle that there is no property interest in the "most beneficial use of the property," even where the claimant already had devoted capital to that use. Penn Central, supra, 438 U.S. at 125. Thus where the challenged statute (a) merely regulated the mining conditions, but did not categorically prohibit surface coal mining, and (b) did not regulate alternative uses of coal-bearing lands, claimants could not demonstrate that "mere enactment" deprived them of economically viable use of their property. Hodel v. Virginia Surface Mining Mining, supra, 452 U.S. at 296-97. [15]

---

[15] See also Goldblatt v. Hempstead, supra, 369 U.S. at 597 n.4 (that appellants made improvements on the lot previously was "not indicative of the loss appellants would presently suffer if the mine were closed; perhaps the improvements are commercially saleable"); Lake Nacimiento Ranch v. San Luis Obispo County, 830 F.2d 977, 981 (9th Cir. 1987) (the test for whether a development restriction denies a plaintiff the economically viable use of its property focuses on the existence of

Third, the utility complaining of a loss must show it has not been compensated already for the risk of loss. It must demonstrate that either (1) the state explicitly refused compensation for risk; or (2) the rate of return methodology imposed by the state during the investment period did not compensate for risk. Resolving the risk-compensation issue requires a state-specific factual analysis. A claimant may not avoid the required factual analysis by asserting to this Court that the specific rate methodology necessarily fails to reflect risk. This Court has properly refused to validate or invalidate facially any particular ratemaking methodology. Federal Power Commission v. Hope Natural Gas Co., 320

---

permissible uses).

U.S. 591, 602 (1943). [16]

b. Was the diminution caused by government action? Diminution alone does not establish a taking. The claimant must show that the challenged government action actually caused the claimed diminution. [17] In short, if the diminution would have occurred without the statute, it cannot be

---

[16] Amicus Pennsylvania Electric Association ("PEA") asserts (Br. at 23) that the state should bear the burden of demonstrating that the utility has already been compensated for risk. But in takings cases this Court has placed the burden of proof on the claimant, consistently. PEA offers no reason for changing this rule in the specific instance of proving failure to compensate for risk. The evidence on this issue is a matter of public record (primarily, state commission orders and the underlying expert testimony). The state, therefore, has no special ability to produce the proof. The burden must remain with the utility.

[17] See Keystone, supra, 107 S.Ct. at 1248 (rejecting takings claim in part because "the categories of coal that must be left [in the ground] for Section 4 purposes and other purposes are not necessarily distinct sets, and there is no information in the record as to how much coal is left in the ground solely because of Section 4").

attributed to the statute.

c. Did the government-induced diminution conflict with distinct, reasonable, investment-backed expectations? To analyze this question fully, we first must clarify (a) the logical relationship between expectations and diminution; and (b) how expectations become property rights.

i. Economic impact and investment-backed expectations are not independent factors; they are causally linked. Unless the economic impact results from interference with expectations, that impact lacks constitutional significance. The reason: There is no taking without governmental destruction of a property right. [18] In the context of economic

---

[18] Note that governmental destruction of a property right is necessary, but not sufficient, to establish a taking. See Andrus, supra, 444 U.S. at 65-66; Keystone, supra, 107 S.Ct. at 1248-49.

regulation, the property right claimed is the right to earn money conducting a specific business. If any right exists, it arises from, and is delimited by, distinct expectations concerning that business. If there are no expectations, there are no property rights with which the government can interfere. And if there is no interference with a property right, then the alleged economic impact must lack constitutional significance.

The Court's decisions confirm this causal relationship between economic impact and expectations. Explaining its rejections of various takings challenges, the Court stated: "[W]hile the challenged government action caused economic harm, it did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes."

Penn Central, supra, 438 U.S. at 124-25. [19] Indeed, the Court's language indicates that economic impact analysis effectively includes expectations analysis: "The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations." Id. [20]

---

[19] See also Keystone, supra, 107 S.Ct. at 1249 (amount of coal required to be left in ground must be "viewed in the context of ... financial-backed expectations").

[20] Cf., Lake Nacimiento, supra, 830 F.2d at 981 n.3 (expectations analysis is relevant only to "as-applied" challenges, where "severity of the regulation's impact on the specific plaintiffs" is at issue).

The Court in Hodel v. Irving also appears to have linked diminution and expectations in a causal relationship. After describing the nature of the diminution -- loss of the right to pass on property -- the majority opinion implied that the right was not very valuable because appellees had only "dubious" expectations in exercising it. Hodel v. Irving, supra, 107 S.Ct. at 2083. Justice Brennan's concurrence (id. at 2084) also emphasizes the causal link. He found that

The link between diminution and expectations surfaces in one further guise. We noted previously that in measuring economic impact, the Court will not carve out the affected property interest and treat it as "taken." The reason: the claimant has no reasonable expectation of using his full bundle of rights without interference. Thus in Penn Central, supra, the Court disagreed with the claimant that "the full use of air rights [was] so bound up with the investment-backed expectations of appellants that governmental deprivation of these rights invariably -- i.e., irrespective of the impact of the

---

the economic impact interfered with specific expectations created by "unique negotiations." Those expectations, he argued, distinguished that case from Andrus v. Allard, where a significant diminution in value survived a taking challenge.

While both the majority opinion and Justice Brennan's concurrence appear to agree on the causal relationship between diminution and expectations, they reached opposite conclusions as to what claimant's expectations were.

restriction on the value of the parcel as a whole -- constitutes a 'taking.'" 438 U.S. at 130 n.27.

ii. "[N]ot all economic interests are 'property rights'; only those economic advantages are 'rights' which have the law back of them...." U.S. v. Willow River Co., supra, 324 U.S. at 502. The question is how to distinguish between economic interests and propery rights. For example, some rights lie at the core of Anglo-Saxon property law. [21] Other rights may flow from expectations created by government consent. [22]

---

[21] See, e.g., Kaiser Aetna, supra, 444 U.S. at 179-80 ("'right to exclude' [is] universally held to be a fundamental element of the property right"); Loretto, supra, 458 U.S. at 441 (property owner has "historically rooted expectation of compensation" for physical invasion); Hodel v. Irving, supra, 107 S.Ct. at 2083 (right to pass on property "has been part of the Anglo-American legal system since feudal times")

[22] Kaiser Aetna, supra, 444 U.S. at 179.

But expectations do not create property rights automatically. [23] As this Court has declared: "Rights, property or otherwise, which are absolute against all the world are certainly rare...." Willow River Co., supra, 324 U.S. at 510 (1945). [24] To get from expectation to property right, the claimant must answer a host of other questions. [25] And whether an expectation

---

[23] See Penn Central, supra, 438 U.S. at 125 (citing cases in which "the challenged government action caused economic harm, [but] did not interfere with interests that were sufficiently bound up with the reasonable expectations of the claimant to constitute 'property' for Fifth Amendment purposes").

[24] See also id. at 499 ("a strategic position for the development of power does not give rise to right to maintain [that positi

[25] In Willow River Co., supra, the claimants, operators of a hydroelectric generation business, owned land adjacent to a river. Based on that ownership, they asserted a property interest in maintaining a certain water level conducive to operation of their plants. In considering the claim, the Court analyzed the following issues: "the claimant's rights in the land to which he claims the water rights to be appurtenant or incidental; on the navigable

amounts to a property right depends in part on the law existing at the time the plaintiff claims to have acquired his property interest. [26] In determining whether state law creates a property right, this Court will defer to lower court interpretations. [27]

---

or non-navigable nature of the waters from which he advantages; on the substance of the enjoyment thereof for which he claims legal protection; on the legal relations of the adversary claimed to be under a duty to observe or compensate his interests; and on whether the conflict is with another private riparian interest or with a public interest in navigation." 324 U.S. at 503.

[26] As the Chief Justice has written: "Reliance on state law is necessitated by the fact that 'property interests ... are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law...." Keystone, supra, 107 S.Ct. at 1259-60 (Rehnquist, J., dissenting). See also Andrus v. Allard, supra, 444 U.S. at 64-65 n.21 ("timing" of acquisition of a property interest, relative to statutes affecting that interest, is relevant to analysis of investment-backed expectations).

[27] Keystone, supra, 107 S.Ct. at 1250.

Finally, to qualify as property rights, expectations must be "distinct." Penn Central, supra, 438 U.S. at 136-37. For Fifth Amendment purposes, "a mere unilateral expectation or an abstract need is not a property interest entitled to protection." Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980) (citations omitted). [28]

Before applying these three questions to this case, we must confront one preliminary issue: Appellants' facial challenge to Section 1315.

2. Appellants' Facial Challenge to Section 1315's Economic Impact Must Fail

Appellants challenge Section 1315 on both "facial" (Br. at 23-26) and

---

[28] See also Board of Regents v. Roth, 408 U.S. 564, 577 (1972) ("To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.").

"as-applied" (Br. at 14-20) grounds. Their facial challenge effectively seeks invalidation of any statute imposing the risk of prudent but uneconomic investment on those initiating the investment. After discussing the different analyses applicable to facial and as-applied challenges, we show that Appellants' facial challenge must fail.

This Court has stated:

> [W]e have recognized an important distinction between a claim that the mere enactment of a statute constitutes a taking and a claim that the particular impact of government action on a specific piece of property requires payment of just compensation.

Keystone, supra, 107 S.Ct. at 1247. A facial challenge is appropriate when the regulation has an improper public purpose or an "extraordinary" character, due to the Court's per se rules in these areas. [29]

---

[29] See, e.g., Pennsylvania Coal, supra (invalidation based on facial challenge to public purpose); Loretto, supra

In the area of economic impact, the matter is more complicated. Depending on whether the challenge is facial or as-applied, different standards will apply. For a facial challenge, the question is whether the government action necessarily "denies an owner economically viable use of his land." Hodel v. Virginia Surface Mining, supra, 452 U.S. at 294-96. [30] An as-applied challenge, in contrast, requires "careful assessment of the impact of the regulation" on the specific affected property, including an inquiry into (1) the extent of interference with distinct expectations, and (2) the permissible remaining uses of the property. Penn Central, supra, 438 U.S. at 136-37.

(invalidation based on facial challenge to character of government action).

[30] Making this type of claim involves an "uphill battle," Keystone, supra, 107 S.Ct. at 1247; and a "heavy burden," id. at 1250.

Where expectations are at issue, the courts have not welcomed facial challenges. "[T]he submission that appellants may establish a 'taking' simply by showing that they have been denied the ability to exploit a property interest that they heretofore had believed was available for development is quite simply untenable." Penn Central, supra, 438 U.S. at 130. That conclusion comports with this Court's view, reiterated just last term, that a facial challenge is a poor vehicle for testing the constitutionality of statutes. [31]

---

[31] "[T]he court below ignored this Court's oft-repeated admonition that the constitutionality of statutes ought not be decided except in an actual factual setting that make such a decision necessary. [Citations omitted] Adherence to this rule is particularly important in cases raising allegations of an unconstitutional taking of private property." Keystone, supra, 107 S.Ct. at 1247. See also Williamson Planning Commission v. Hamilton Bank, 473 U.S. 172, 190-91 and n.12 (1985) (the question whether a regulation interferes with reasonable, distinct investment-backed expectations belongs in an as-applied challenge, not a facial challenge).

The foregoing principles support the causal link drawn in Part I.D.1.c, supra, between the economic impact factor and the expectations factor. Unless the economic diminution flows from a breach of expectations, we argued above, the economic impact has no constitutional significance. Before determining whether economic impact is constitutionally relevant, therefore, one must investigate the claim of expectations, including all circumstances consistent or inconsistent with such claim. That factual investigation is impossible in the context of a facial challenge.

Appellants do not make the traditional facial challenge -- that Section 1315 renders their property economically unviable. Rather, their facial challenge proceeds argue as follows: (1) we had an expectation of recovery of the specific investment; (2) Section 1315's denial of recovery conflicted with that expectation;

(3) therefore, Section 1315 is a taking. That argument collides with this Court's instructions not to resolve expectations questions in the context of a facial challenge.

We turn now to Appellants' as-applied challenges.

3. Appellants Have Not Demonstrated That Section 1315, As Applied, Diminishes Shareholder Value

a. Appellants have not shown the absence of alternative uses for their investment. To establish any diminution in value, Appellants must show, inter alia, that they cannot put their investment to alternative uses. Appellants bear the burden of proof on this issue. [32]

---

[32] See Andrus v. Allard, supra, 444 U.S. at 66 (claimants lost because they could not show they were "unable to derive economic benefit from the artifacts"); Penn Central, supra, 438 U.S. at 136 ("it simply cannot be maintained, on this record, that appellants have been prohibited from occupying any portion of the airspace above the Terminal").

Appellants have made no such showing. Nor could they, since they can put their investment to a variety of uses. For example:

Appellants' cancellation decision was voluntary. They can reverse that decision and continue to build one or more plants. Then they can seek buyers on the wholesale market from whom to recover their investment. [33] Or, the engineering reports and other fruits of the cancelled investment could be shared for a fee with

---

[33] Throughout their briefs, Appellants and supporting amici suggest that the only way for them to recoup their cancelled plants investment is to foist the costs onto captive retail customers. That is incorrect. In recent years, a thriving wholesale electric market has come to life. Some utilities use this market as an outlet for excess plant capacity not needed to serve their retail traditional loads. Other utilities are seeking to build plants expressly for the purpose of serving this interstate wholesale market. See generally Notice of Proposed Rulemaking, "Regulations Governing Independent Power Producers," RM88-4-000 (Federal Energy Regulatory Commission Mar. 16, 1988).

other utilities planning similar projects, or used for internal planning or training purposes. [34]

Appellants may argue that unlike the property in Andrus v. Allard, supra, their $50 million in cancellation costs -- consisting of engineering reports and other allegedly nonproductive assets -- has no salvage or other value whatsoever. Nothing on the record supports that argument. But even assuming the absence of value, that fact is not attributable to Section 1315. Rather, it is attributable to Appellants' voluntary choice to build the kind of plant they built. Had they sought to meet their predicted load through, for example, a series of small power plants, each costing

---

[34] Cf., Andrus v. Allard, supra, 444 U.S. at 66 (claimants could exhibit unmarketable avian artifacts for a fee); MacLeod v. Santa Clara County, 749 F.2d 541, 547 (9th Cir. 1984) (denial of right to harvest timber not a taking; affected ranch owner retained the right to, inter alia, continue to hold the property as an invest

$50 million, their cancellation decision might have left them with one completed plant, which now might have market value. Where the utility, not the state, chose the nature of the investment, the utility, not the state, must bear the risk that the result will lack market value.

In short, the Pennsylvania statute does not preclude all beneficial uses of the investment. It precludes only one use: charging captive customers for goods they do not want.

b. Even if Appellants can demonstrate diminution, they cannot blame the statute. To test if the Pennsylvania statute was responsible for Appellants' claimed loss, assume that the statute stated the opposite; i.e., that it did permit recovery from retail ratepayers of the cancellation costs. Would the Appellants then recover the money? Not necessarily. If Appellants raised their price to recover the cancelled

plant costs, customers might reduce their purchases and leave Appellants with lower revenues. [35] Appellants, who bear the burden of proof on this issue, have not established that the statute's denial of recovery rights in fact cost them anything.

In light of this failure of proof, Appellants' argument can succeed only if this Court finds that captive ratepayers have a constitutional duty to buy a product they have not ordered and do not want. That is not, and should not be, the law. See Market St. Railway, supra, 324 U.S. at 567 ("The due process clause ... has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.").

---

[35] See J. BONBRIGHT, A. DANIELSEN, D. KAMERSCHEN, PRINCIPLES OF PUBLIC UTILITY RATES 358 (1988) (discussing "elasticity of demand"). Cf., Market St. Railway v. Railroad Commission, 324 U.S. 548 (1945) (utility not entitled to higher rate where it was not clear customers would pay it).

4. Section 1315, As Applied, Does Not Interfere With Any Distinct, Reasonable, Investment-Backed Expectation

The burden lies on the claimant to demonstrate distinct, reasonable, investment-backed expectations. See Hodel v. Irving, supra, 107 S.Ct. at 2083. As discussed below, Appellants cannot carry that burden.

a. At the time they undertook construction, Appellants had no reasonable basis for assuming that ratepayers would insulate them from economic risk. At the time Appellants undertook to build the plants at issue here, Pennsylvania utility rate doctrine had long held that property not providing current service could not be charged to ratepayers. For example, in City of Pittsburgh v. Pennsylvania Public Utility Commission, 171 Pa. Super. 187, 90 A.2d 607 (1952), the court refused to allow Duquesne to charge ratepayers for a return

either of or on a $708,913 investment in coal property. Despite Duquesne's good intentions, the property "has not been developed, is not presently in use, nor is there evidence that it will be used in the near future." 90 A.2d at 615. Similarly, in Schuykill Valley Lines v. Pennsylvania Public Utility Commission, 165 Pa. Super. 393, 68 A.2d 448 (Pa. 1949), the court noted that "although plans have been drawn for a proposed [office] building, no contracts have been let and the work has been deferred indefinitely due to high construction costs." 68 A.2d at 451-52. The court upheld the Commission's denial of cost recovery since the land "was not property devoted to a public use." 68 A.2d at 452.

The principle articulated in Schuykill -- that a Pennsylvania utility may not recover costs from ratepayers for investments that are not providing current

service to ratepayers -- has been brought forward to this decade in an uninterrupted line of cases. [36]

Appellants had early notice of Pennsylvania's ratemaking policy through direct experience. See Duquesne Light Co. v. Pennsylvania Public Utility Commission, 107 A.2d 745, 752 (Pa. 1954). And in its 1972 retail rate case, just at the time it initiated the investment controverted here, Duquesne was reminded it could recover plant investment (along with a return on that investment) only "when plant is placed in service." Pennsylvania Public Utility Commission v. Duquesne Light Co., 97 P.U.R.3d 227, 256 (Penn. PUC 1972).

---

[36] See, e.g., Duquesne Light Co. v. Pennsylvania Public Utility Commission, 107 A.2d 745, 752 (Pa. 1954); cited in Bell Tele. Co. v. Pennsylvania Public Utility Commission, 408 A.2d 917, 926 (Pa. Commw. 1979); cited in West Penn Power Co. v. Pennsylvania Public Utility Commission, 412 A.2d 903 (Pa. Commw. 1980

As is clear from this review, a utility in Pennsylvania in 1972 could expect to recover its investment, and receive a return on it, only by satisfying two tests: (1) completing construction, and (2) placing the plant in service. These tests had been part of the jurisprudence of Pennsylvania for years. [37]

It is unreasonable to expect that the state would have discarded this staple of utility ratemaking -- i.e., investors are responsible for risk prior to property being placed into service -- without saying

---

[37] In a 1974 decision, the Pennsylvania Commission again applied the principle in a very real way to one of Appellants. Pennsylvania Public Utilities Commission v. Duquesne Light Co., 5 P.U.R.4th 202 (Penn. PUC 1974). The Commission there denied return (both of and on investment) for certain power plants that had been retired even though not fully depreciated. 5 P.U.R.4th at 206-208. Just as importantly, the Commission denied a return both of and on investment for, among other things, certain "transmission plant constructed in various years but never placed in service...." Id. at 211.

sc expressly. Indeed, the Pennsylvania Supreme Court, in the opinion below, did not discard the precedent; it reiterated the precedent. Specifically, the court found that "fundamental principles of [Pennsylvania's] public utility jurisprudence" prohibited the recovery of costs from ratepayers not associated with the actual provision of present utility service to ratepayers. Barasch v. Pennsylvania Pub. Util. Comm'n, 532 A.2d 325, 338 (Pa. 1987). Section 1315, the court held (id. at 37),

> was mainly an attempt by the 1982 legislature to make clear, by codification, that the above mentioned general principles of utility law should govern the then-ongoing efforts of some electric utilities to recover cancelled plant costs from their customers. (emphasis added)

A different historical policy certainly was not mandated by the Constitution. Ratepayers never have acted as insurers of a utility investment. The Constitution

"has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces." Market Street Railway Co., supra, 324 U.S. at 567.

b. Appellants' rendition of pre-construction events does not support their claim that they reasonably expected protection from economic risk. This is not a case where an unwilling utility was ordered to undertake a risky venture and then denied cost recovery for it. Nothing in the events leading up to the construction of the plant supports Appellants' claim that they reasonably could expect protection from the ratemaking risks discussed above.

In the early 1970s, the Pennsylvania Commission had expressed a "concern" about "whether current plans are satisfactory to meet projected future needs for electric power." Investigation of the Need for

Additional Electric Generating and Transmission Facilities, 46 Pa. P.U.C. 23, 25 (1972). At the same time, the Commission recognized that among the "possible changes in conditions which may affect the demand of future power during the next several decades" was the "developing trend to conserve the use of electric service and a moratorium on the promotion of total electric residential living units." Id. That is hardly language mandating power plant construction.

In the same opinion, the Commission articulated a clear division of responsibility between itself and management. In "review[ing] the revised plans of electric utilities," id. at 26, the Commission would act in an oversight capacity only. The plans would be initiated and implemented by the utilities. No state review would occur until the

utility included particular plants in reports filed with the Commission. The Commission's role would be passive; Appellants' role active. [38]

In short, no one told Appellants what strategies to pursue to match capacity with demand, or demand with capacity. Nonnuclear, nonconstruction options were readily available. But Appellants chose the generation option, and they chose the nuclear option. Those choices, while deemed prudent by the Commission, were not without risks. The electric utility industry debate, as to whether or not to respond to the risk of future energy shortages by forever increasing capital expansion, had already begun. [39]

---

[38] Contrast West Palm Beach Water Co. v. City of West Palm Beach, P.U.R. 1930A 177 (S.D.Fla. 1928) (aff'g Report of Special Master).

[39] See, e.g., Case and Schoenbrod, Electricity or the Environment: A Study of Public Regulation without Public Control,

That Pennsylvania encouraged Appellants to pursue some response to the predicted gap between demand and capacity does not make Appellants' voluntary decision to build generation, and to build nuclear generation, the decision of the state. Under somewhat different circumstances, this Court has addressed when the actions of a utility can be held to be the responsibility of the state. In Jackson v. Metropolitan Edison Co., 419 U.S. 345 (1974), a customer argued that state approval of the utility's service disconnections made those disconnections were the actions of the state. 419 U.S. at 354-55. This Court disagreed. Approval of utility actions, "where the commission has not put its own weight on the side of the proposed practice by ordering it, does not

---

61 CALIF. L. REV. 961, 972 (1973); Lippek, Power and the Environment: A Statutory Approach to Electric Facility Siting, 47 WASH. L. REV. 35, 49 (1971).

transmute a practice initiated by the utility and approved by the commission into `state action.'" Id. at 357.

c. Appellants have not shown they were not compensated for economicy risk. To demonstrate they had a reasonable expectation of freedom from economic risk, Appellants must show they have not been compensated already for that risk. Appellants make no such showing. Nor can they.

Appellants earn a rate of return. That rate of return reflects some type of risk. By asserting that they are insulated from the risk of uneconomic results, Appellants imply that the risk for which the rate of return compensates them is the risk of management imprudence. That cannot be correct. Seminal rate of return cases make clear that in setting a utility's rate of return, there is an assumption of prudent

and efficient management. [40] Ratepayers are never expected to compensate a utility for negligent, wasteful or improvident expenditures; or, by implication, for the risk of such expenditures. [41] The risk of imprudence simply is not a cost that utilities may pass on to their customers. Determining a response to management imprudence is a matter strictly between the utility's investors and the management they hired.

If the risk of imprudence is not compensable through the authorized rate of return, then what risk is reflected in that return? Compensation for the risk of

---

[40] See Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944); Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1923).

[41] West Ohio Gas Co. v. Ohio Public Utilities Commission, 294 U.S. 63 (1935); Reagan v. Farmers' Loan and Trust Co., 154 U.S. 362 (1894). See also Missouri ex rel. S.W. Bell Tel. Co. v. Public Service Comm'n, 262 U.S. 276, 290 n.1 (1923) (Brandeis, J., dissenting).

uneconomic results, for one. That risk is a major primary factor in determining the rate of return allowed for utility debt and equity instruments included in the utility's capital structure. [42] Among these economic risks: (a) a nuclear plant might not be licensed to operate due to unresolved safety factors; [43] (b) a particular supply of energy might be rendered unnecessary because of more adequate substitute supplies; [44] and (c) an enterprise might be rendered uneconomic due to the presence of competition; [45] including, by implication, "competition"

---

[42] Hope Natural Gas Co., supra, 320 U.S. at 603; Bluefield Water Works, supra, 262 U.S. at 691-93 (1923). Cf., BONBRIGHT, supra at 316, 322-25.

[43] Power Reactor Development Co. v. Electricians, 367 U.S. 396, 415 (1961).

[44] Los Angeles Gas and Electric Corp. v. Railroad Commission of California, 289 U.S. 287, 306 (1933).

[45] Market Street Railway, supra, 324 U.S. at 567.

from consumer conservation, alternative fuels, and other contributors to declining demand.

In short, Appellants have been compensated already for precisely the risk which befell them here. It would be illogical, and unfair, to require consumers to compensate investors for the risk of loss and then to exact the actual loss from consumers should it occur. Jersey Central Power and Light Co. v. FERC, supra, 810 F.2d at 1208-09 (dissenting opinion). [46]

* * * * *

The foregoing discussion demonstrates that Pennsylvania and federal case law furnished no basis for any reasonable

---

[46] That cited passage was not challenged by the majority. See also Washington Gas Light Co. v. Baker, supra, 188 F.2d at 20 ("Ratepayers cannot be required both to carry this risk and to pay the Company for carrying it."). Accord, Petition of Public Service Co. of New Hampshire, No. 87-311, slip op. at 10 (N.H. Jan. 26, 1988).

expectation on Appellants' part that their plant investment would be insulated from economic risk. Moreover, none of the events directly leading to Appellants' investment decision altered this expectation landscape. Only one possible argument remains: that (1) Appellants' initial franchise provided, in return for their agreeing to serve the public, a state promise to insulate them from economic risk; and that (2) such promise amounted to a property right protected by the Fifth Amendment. That argument is directly contradicted by Pennsylvania law. "A certificate of public convenience [to serve the public] is neither a contract nor a property interest under which its holder acquires vested rights." Western Pa. Water Co. v. Commonwealth of Pennsylvania, 10 Pa.

Commw. 533, 311 A.2d 370, 375 (1973). [47]
For these reasons, Appellants' expectations argument must fail.

The facts set forth above are undisputed. Thus this Court has more than ample basis for upholding the Pennsylvania Supreme Court's decision. But if there is a factual dispute (and we do not believe there is one), this Court may not resolve it. The state courts must be the final interpreters of state events and state law.

Keystone, supra, 107 S.Ct. at 1259-60

---

[47] See also Snyder v. Pennsylvania Public Utility Commission, 187 Pa.Super. 147, 144 A.2d 468, 470 (1958); Paradise v. Pennsylvania Public Utility Commission, 184 Pa.Super. 8, 132 A.2d 754, 758 (1957); Day v. Public Service Commission, 312 Pa. 381, 167 A. 565, 567 (1933). Cf., Montana Power Co. v. Montana Public Service Commission, 692 P.2d 423 (Mont. 1984) (certificate of convenience and necessity approving plant construction of makes no commitment to any future ratemaking treatment); Iowa-Illinois Gas and Electric Co. v. Iowa State Commerce Commission, 412 N.W.2d 600, 605-06 (Iowa 1987) (same). Compare Kaiser Aetna, supra (government consent to investment created expectation amounting to property right).

(Rehnquist, J., dissenting). [48]

II. THE METHOD FOR ASSIGNING PROSPECTIVELY THE RISK OF UNECONOMIC INVESTMENT IS A MATTER OF POLICY, NOT CONSTITUTIONAL LAW

This Court has held repeatedly that the Constitution does not dictate any particular method of ratemaking so long as the end result is just and reasonable. Moreover, this Court will not "inquire whether the rule applied by the state court is right or wrong, or substitute its own

---

[48] While this Court's takings analyses have involved "essentially ad hoc, factual inquiries," Hodel v. Irving, 107 S.Ct. 2076, 2082 (1987) (quoting Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979)) the Court in those cases has not been a fact finder. Rather, the Court has weighed the facts before it, to determine when "'justice and fairness' require that economic injuries caused by public action be compensated." Kaiser Aetna, supra, 444 U.S. at 175 (quoting Penn Central, supra, 438 U.S. at 124). The task of resolving factual disputes has remained with the lower courts. Cf., Hodel v. Irving, 107 S.Ct. 2076, 2084 (1987) (Brennan, J., concurring) (relying on Court of Appeals' finding that negotiations giving rise to plaintiff's property rights had created specific expectations).

view of what should be deemed the better rule, for that of the state court." Demorest v. City Bank Co., 321 U.S. 36, 41-43 (1944).

Deference is particularly important where there exists a multitude of state regulatory agencies determining just and reasonable rates under differing state statutes and policies. New York, for example, allows a return both of and on prudent investment in cancelled plants. New York views this allowance as consistent with the utility's undertaking the obligation to serve. [49] Other states permit recovery of, but not return on, the amounts invested in the cancelled plant. They view the ratepayer-investor relationship as a joint venture which

---

[49] See, e.g., Rochester Gas and Elec. Corp., 45 P.U.R.4th 386 (NY PSC 1982).

requires a sharing of risks and costs. [50] Still other states permit a return of investment, but limit such return to the cost of long-term debt (thus denying a return on equity). These states reason that while equity investors have a say in the management of the utility, holders of debt do not; therefore, the latter group should not be held responsible management's uneconomic decisions. [51]

---

[50] See, e.g., Atlantic City Elec. Co., 51 P.U.R.4th 109 (N.J.Bd. of P.U. 1983); Bangor-Hydro Elec. Co., 46 P.U.R. 503 (Me. PUC 1982).

[51] See, e.g., Carolina Power and Light Co., 49 P.U.R. 4th 188 (N.C. Util. Comm'n 1982); Potomac Elec. Power Co., 50 P.U.R.4th 500 (D.C. PSC 1982). For a review of plant cancellation decisions, see generally Sommers, Recovery of Electric Utility Losses from Abandoned Construction Projects, 8 WM. MITCHELL L. REV. 363, 371, n.43 (1982); Wilson, Ratemaking Treatment of Abandoned Generating Plant Losses, 8 WM. MITCHELL L. REV. 343, 352-358 (1982). See also Cleaves, Constitutional Protection for the Utility Investor: The Confiscation Doctrine after Cleveland Electric Illuminating Co. v. Public Utilities Commission of Ohio," 12 B.C.L. ENVTL. L. REV. 527 (1985).

Recoupment of all or part of a return of and on and investment is not a universal policy, however. In Oregon and other states, recovery of cancelled plant costs is forbidden by statute. [52] These states have opted for a regulatory scheme that imposes the entire risk of non-operational plant on investors. Still other states have barred the passthrough to ratepayers of cancelled plant costs, but require explicit compensation for investors undertaking this risk of non-operation. [53]

---

[52] See, e.g., Pacific Power & Light Co., 49 P.U.R.4th 82 (Or. PUC 1982); Portland Gen. Elec. Co., 49 P.U.R.4th 274 (Or. PUC 1982). Accord, Pacific Power and Light Co., 53 P.U.R.4th 24 (Mont. PSC 1983); Lower Valley & Light, Inc., No. 9617-sub 11, at 9 (Wyo. PSC Dec. 2, 1982) (denying recovery for the cancelled WPPSS 4 and 5 and the Pebble Spring plants).

[53] Compare Office of Consumers' Counsel v. Public Utilities Commission, 67 Ohio St. 153, 423 N.E.2d 820 (1981) (denial of recovery mandated by statute), appeal dismissed, 455 U.S. 914 (1982); with Office of Consumers' Counsel v. Public Utility Commission, 4 Ohio St. 3d 111, 115, 447

A final ratemaking option is to eschew establishing a doctrine involving the "up-front" allocation of risk. Instead, a a post-construction review would apportion cancellation costs in some fashion determined to be "just and reasonable." This option is consistent with this Court's holding in Hope Natural Gas, supra: [I]t is the result reached not the method employed which is controlling." 320 U.S. at 602. [54]

This Court should not supersede this rich variety of approaches to risk

---

N.E.2d 749, 753-54 (1983) (approving commission's subsequent action raising utility's rate of return due to increased risk resulting from the cost recovery decision). Accord, Washington Utils. & Trans. Commission v. Pacific Power and Light Co., 52 P.U.R.4th 148 (Wash. UTC 1983).

[54] Of course, if there was no clear risk allocation rule determined in advance of construction, the authorized rate of return during construction would have to reflect the uncertainty over the later risk allocation.

assignment by imposing a single ratemaking method under the guise of constitutional construction. As discussed in Part I.A, supra, the Constitution requires only that the rate methodology not conflict with distinct, reasonable, investment-backed expectations. In the utility regulatory arena, whether such a conflict occurs may depend on specific expectation-creating events like Commission orders, utility proposals, or the absence of such orders and proposals. These events will vary in each regulatory jurisdiction.

Amicus Pennsylvania Electric Association ("PEA") concedes that "there are several methods of ratemaking that, at least in theory, would fully protect the ultimate constitutional interest," Br. at 23, and that "any standard that fairly balances the benefits and burdens of regulation can satisfy constitutional standards," id. at 17 n.13. Yet PEA

instead would impose a single standard, the "prudent investment" standard, as a matter of constitutional doctrine. PEA cites no authority for the principle that this approach is the "appropriate ... constitutional benchmark." No such authority exists.

The prudent investment standard has been rejected as illogical, let alone as constitutionally-imposed doctrine. Specifically, the standard misconstrues the purpose of excluding nonoperational plant from rates. The various methods cited above are means of allocating risk; they are not methods of punishing a "culpable" party. As the Pennsylvania Commission noted, where a utility overbuilt capacity:

> [T]he fact that excessive plant investments were prudent when made does not necessarily preclude the Commission from allotting responsibility for their cost....The sudden burden of this new plant investment was no fault of Penn Power of its investors; but neither was it the fault of the

ratepayers.

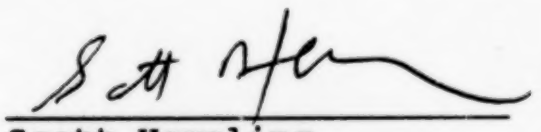
Philadelphia Electric Co. v. Pennsylvania Public Utility Commission, 37 P.U.R.4th 381, 387 (Penn. PUC 1980). Where, by assumption, no one is at fault, it is illogical to assign costs based on the absence of fault. But that is exactly what the prudent investment approach does.

The prudent management approach fails on a policy level as well. By focusing narrowly on the prudence of the decision to build, the prudent investment policy weakens any incentive to improve management processes. Ratepayers and the public at large, benefits from (1) accurate demand forecasting; (2) precise determinations of the type and timing of new capacity needs; and (3) meaningful review of ongoing construction. If rates are based only on whether utility management is imprudent or is acting in bad faith, little if any economic incentive will exist for

management to produce these important benefits.

CONCLUSION

WHEREFORE, for the foregoing reasons, Amici respectfully request this Court to affirm the decision below.



Scott Hempling
Counsel of Record
Environmental Action
Foundation
1525 New Hampshire Ave.
Washington, DC 20036

Roger Colton
72 Maple St.
Belmont, MA 02178

June 30, 1988

CERTIFICATE OF SERVICE

I hereby certify that on June 30, 1988, I served a copy of the foregoing document on those persons listed below, by depositing the appropriate number of copies thereof in the United States mail, postage prepaid, or by equivalent method of service:

William E. Zeiter, Esq.
Morgan, Lewis & Bockius
2000 One Logan Square
Philadelphia, PA 19103

Irwin A. Popowsky, Esq.
Office of Consumer Advocate
1425 Strawberry Sq.
Harrisburg, PA 17120

Bohdan R. Pankiw, Esq.
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17120

Scott Hempling